

STAFF REQUEST FOR PERMISSION TO PROCEED ON PROPOSED CHANGES TO
CALIFORNIA CODE OF REGULATIONS, TITLE 18, REGULATION 18001-1,
SUBSECTION (C), RELATING TO CREDIT FOR TAXES PAID TO ANOTHER STATE

Pursuant to Board Resolution 98-7, staff requests permission to notice draft proposed changes to the existing regulation at California Code of Regulations, title 18, section 18001-1, subsection (c). These proposed changes address the timing of claiming the credit from California for taxes paid to another state.

Staff requests the Board to authorize immediate commencement of a regulation project to amend regulation 18001-1. Currently, the regulation text provides that the credit for income taxes paid to another state will only be applied against "net tax" imposed on the income in the same year. However, the governing statute (Revenue and Taxation Code section 18001, subdivision (a)) does not require that the credit be applied only against the "net tax" on the income in the *"same year."* Instead, the credit for taxes paid to another state may be properly claimed when the same income that was taxed by the other state is also taxed by California. The proposed change to the regulation eliminates the requirement that the income for which the credit is claimed be recognized in the same year for both states.

Since this amendment should be non-controversial, as it clarifies and increases taxpayers' ability to claim the other state tax credit, staff believes that no symposium is necessary. Staff, therefore, recommends that the Board authorize staff to proceed immediately with the formal regulatory process. The text of the proposed amendment and a brief explanation of it will be placed on the department's web site.

Section 18001-1 is amended to read:

§ 18001-1. Credit for Taxes Paid to Another State.

(a) Subject to the limitations described in Reg. 18001-2 respecting residents, and in Section 18002 respecting nonresidents, resident taxpayers are allowed a credit against “net tax”, as defined in Section 17039, for net income taxes paid another state, and nonresidents are allowed a credit against “net tax”, as defined in Section 17039, or net income taxes paid to the state in which they reside. The term “state” as used in the regulations contained in this Group for taxable years beginning before December 31, 1956, includes states, foreign countries, territories and possessions of the United States, and territories, possessions and political subdivisions of foreign countries, but did not include the United States. For taxable years beginning after December 31, 1956, the term “state” includes states of the United States, the District of Columbia and the possessions of the United States, but does not include the United States or foreign countries. The credit is limited to “net tax” and may neither be taken on account of any preference, alternative, or minimum tax comparable to the tax imposed by Section 17062 paid to another state or interest or penalties paid to another state nor may the credit be applied against interest or penalties due under the law. Since credit may be allowed only for net income taxes or, in the case of shareholders of a S corporation, the shareholders' prorata share of any taxes on, according to or measured by income or profits which were paid by the S corporation and satisfy the requirements of Revenue and Taxation Code section 18006, subdivision (b), no credit may be allowed for taxes imposed on gross receipts, gross income, dividends, etc., which must be paid regardless of whether or not the subject of the tax constitutes net income, even though in particular instances the subject taxed is net income in whole or in part. A taxpayer may also be required to report only the net amount of dividends if a tax is imposed by a foreign country upon the profits of the corporation and the corporation deducts the tax from each dividend payment before remitting the remainder.

(b) The credit may be taken either at the time of filing returns under the law or subsequently and may be applied against the entire “net tax” if it is not paid in installments, or may be applied against each installment until the credit is exhausted. However, no credit will be allowed on account of income taxes imposed by another state or country until such taxes are actually paid. Receipts showing the payment of such taxes, and a certified copy of the return or returns upon the basis of which such taxes are assessed must be filed with the Franchise Tax Board at or prior to the time credit is claimed. If credit is claimed on account of a deficiency assessment, a certified copy of the notice assessing, or proposing, to assess the deficiency, as well as a receipt showing the payment of the deficiency must be filed.

(c) ~~Credit for income taxes paid another state on income for any year may be applied only against “net tax” imposed on income for the same year.~~ If, for any reason, the “net tax” has been paid before credit is claimed, a refund claim (accompanied by a receipt showing payment of the taxes claimed as a credit and a certified copy of the return or returns upon which the taxes were assessed) in the amount of the credit must be filed

(see Part 10.2, Chapter 6 respecting the time and manner of filing refund claims). If the refund claim is approved, the amount of the claim will either be allowed as a credit against “net tax” or refunded to the taxpayer in the manner specified in Part 10.2, Chapter 6.

(d) If a husband and wife file separate returns under the law and also file separate returns in another state, credit on account of taxes paid to the other state may be claimed by each spouse only to the extent the income of each spouse as reported under the law, has been taxed by the other state. If a husband and wife file a joint return under the law, the entire amount of taxes (subject to limitations described in Reg. 18001-2 and Section 18002) paid by either or both to another state may be claimed as a credit, regardless of whether the husband and wife filed a joint return or separate returns in such state. If a husband and wife file separate returns under the law but file a joint return in another state, each is entitled to credit (subject to the limitations described in Reg. 18001-2 and Section 18002) for that portion of the total tax paid to such other state which the income of each taxed under the law and also taxed by such other state bears to the total income taxed by such other state.

(e) For provisions relating to credit allowed:

- (1) An estate or trust, see Sections 18003-04;
- (2) Resident beneficiaries of an estate or trust for taxes paid by the estate or trust on income taxable to the beneficiaries, see Section 18005;
- (3) Members of a partnership where a net income tax is levied on the partnership, see Section 18006;
- (4) Shareholders of an S corporation where the S corporation has paid “net income taxes” to another state, which include taxes on, or according to, or measured by, income or profits paid, see Section 18006; and
- (5) In a case where the taxpayer at any time obtains credit for, or a refund of, taxes paid another state, see Sections 18007-09.

Note: Authority cited: Section 19503, Revenue and Taxation Code.

Reference: Sections 18001 and 18002, Revenue and Taxation Code.